

The Aquadis case: Québec Court of Appeal confirms the broad powers of the CCAA monitor

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On May 21, 2020, the Québec Court of Appeal (QCA) released its reasons in *Arrangement relatif à 9323-7055 Québec inc. (Aquadis International Inc.)*^[1] (the Aquadis case).

In a unanimous decision, the QCA dismissed the appeal of the trial judge's decision thereby confirming that a monitor under the *Companies' Creditors Arrangement Act*^[2] (CCAA) may exercise the rights of creditors, rather than those of the debtor, to initiate legal proceedings against third parties with a view to maximizing recovery for the benefit of the debtor's CCAA estate.

This decision brings the powers of a CCAA monitor closer to those of a trustee in bankruptcy and provides an additional tool to increase creditor recovery in a liquidating CCAA.

Background

Aquadis International Inc. (Aquadis) was founded in 1993. The company imported and distributed plumbing and heating equipment and supplies, including faucets. Aquadis acquired the faucets from a Chinese distributor, Gearex, which in turn acquired them from a Chinese manufacturer, Jing Yudh Industrial Co. (JYIC). The purchased faucets were resold by Aquadis to various hardware retailers in Québec (the Retailers), which in turn resold the faucets to consumers and contractors.

Due to water damage caused by defective faucets, legal proceedings were instituted against Aquadis by insurers subrogated to their insureds' rights. Faced with mounting claims, Aquadis had no choice but to file a notice of intention under the *Bankruptcy and Insolvency Act*^[3] (BIA). The proceedings were subsequently continued under the CCAA and Raymond Chabot Inc. was appointed monitor (the Monitor). As a result of the filing of the notice of intention, the proceedings instituted by the insurers against Aquadis were stayed.

On November 9, 2016, the Monitor sought an order to amend its powers as follows: "to conclude transactions or, failing that, to take proceedings against persons having resold or installed defective products purchased from Aquadis, such as distributors, retailers, and general contractors."^[4] That motion was granted on November 14, 2016 (the November 2016 Order), thereby granting the Monitor the right to commence or continue any action in the name of Aquadis' creditors. The decision was not appealed.

Following the November 2016 Order, the Monitor acted on two fronts. First, it commenced negotiations with the Retailers, hoping to implement a "global settlement," pursuant to

which in exchange for releases from liability related to the defective faucets, the Retailers would contribute to a “litigation pool.” However, the negotiations were inconclusive. Second, it instituted legal proceedings against JYIC and Gearex (manufacturers of the defective faucets), which resulted in settlements with insurers and the receipt of more than \$7 million in consideration of full releases. Although those settlements were contested by the Retailers, they were approved by the CCAA judge on June 20, 2018.

In 2019, the Monitor filed the Plan of Arrangement (the Plan) that provided for the establishment of a “litigation pool” including all of the sums recovered by the Monitor and the Monitor’s power to institute legal proceedings against the Retailers on behalf of the creditors. The Plan was unanimously approved by the creditors.

The Retailers opposed the Plan on the basis that Aquadis had no right of action against them and that the objectives of the CCAA were frustrated by allowing the Monitor to pursue a remedy to which it is not entitled.

On July 4, 2019, the CCAA judge approved the Plan notwithstanding the Retailers’ contestation. In doing so, the CCAA judge emphasized that in the absence of consensual settlements, proceedings against the Retailers are the only possible solution to Aquadis’ liabilities. As such, according to the CCAA judge, the powers requested by the Monitor were necessary to advance the restructuring process and the only practical resolution of the matter. Additionally, the CCAA judge noted that the Retailers failed to challenge the November 2016 Order. Thus, their challenge of such power in the Plan of Arrangement was late.

The Retailers appealed. Meanwhile, the Monitor instituted proceedings against the Retailers, which were suspended pending the judgment of the QCA.

Decision

Two questions were raised before the QCA: (1) should a CCAA monitor be entitled to exercise the rights of certain creditors to initiate legal proceedings against third parties; and (2) does the Retailers’ failure to challenge the November 2016 Order prevent them from challenging the application for approval of the corresponding provision of the Plan. The QCA answered the first question in the affirmative and found no reviewable error in the decision at first instance. As to the second question, the QCA was not required to provide an answer given its decision in respect of the first question, but nonetheless provided some comments in *obiter*.

Monitor’s rights and powers

On appeal, the Retailers argued that the powers granted by the Plan were contrary to section 23 of the CCAA and contravened the principle of neutrality of the Monitor and, considering that they are not insolvent, proceedings under the umbrella of the CCAA should not apply to them.^[5]

The QCA dismissed the Retailers’ argument to the effect that the powers granted to the Monitor by the trial decision are contrary to the meaning of section 23 of the CCAA. In the context of Aquadis’ CCAA proceedings, the Monitor’s goal was to maximize the creditors’ recovery by establishing a “litigation pool” for distribution to Aquadis’ creditors. According to the QCA, such an objective fits squarely within the spirit of the CCAA and is supported by numerous examples in the case law where releases were granted to third parties in exchange for their voluntary contribution to “litigation pools.”^[6]

Section 23 of the CCAA sets out the powers and duties of the monitor. The courts have jurisdiction to use their discretion to extend such powers. Such discretion is not to be exercised arbitrarily, but in accordance with the objectives of the CCAA,^[7] which in the case of the Aquadis CCAA proceedings would include maximizing the creditors' recovery. The QCA was presented with two seemingly competing lines of case law as to the powers of the monitor and their extension by the courts. In *Essar*,^[8] the Ontario Court of Appeal confirmed the monitor's power to institute oppression proceedings for the benefit of various stakeholders in the CCAA estate. In contrast, several other cases^[9] adopted a more limited view of the monitor's powers.

In its decision, the QCA underscored two key aspects supporting expansion of the monitor's powers: the wide acceptance of liquidating CCAAs^[10] as a legitimate use of the CCAA statute and the growing trend of super-monitors in practice.

The QCA further found that the powers granted to the Monitor by the CCAA judge in Aquadis were justified not only from a commercial or practical point of view, but also from a legal point of view for the following reasons:

- Since 2007, BIA recourses are available to CCAA monitors. Under the BIA, a trustee can exercise rights not only for the benefit of the debtor but also for the benefit of the creditors. It may exercise rights and recourses on behalf of creditors against other creditors or third parties such as a recourse pursuant to section 95 of the BIA. Thus, the Monitor's power to enforce rights of creditors is not foreign to insolvency law.
- The Retailers are not creditors, but third parties. Thus, they are not participating in the "litigation pool" set out under the Plan.
- The creditors voted unanimously for the Monitor to exercise their rights against the Retailers in the context of the CCAA proceedings. Accordingly, the Monitor is acting in conformity with the collective will of the creditors. Thus, the trial decision was in line with the creditor democracy reflected in the CCAA and was a sound basis for approving the Plan.

As to the Retailers' argument concerning the Monitor's neutrality, the QCA pointed out that it was recognized by the case law and doctrine that a monitor's neutrality is far from absolute, provided that the monitor is objective, unbiased and pursuing legitimate CCAA objectives. In the case at hand, the Retailers were not creditors nor stakeholders in the CCAA estate,^[11] and accordingly, the Monitor had no duty to them as third parties. Ultimately, the QCA found that the Monitor had acted with full transparency and due process.

As to the Retailers' constitutional argument, the QCA held that as long as the powers granted to the Monitor were in furtherance of the objectives of the CCAA, the consequences of the exercise of such powers does not result in an infringement on the constitutional division of powers. In the case at bar, the Plan provided for releases to be granted to those Retailers that would contribute to the "litigation pool." To this effect, additional powers were granted to the Monitor to compel such contribution by instituting legal proceedings. Such powers were granted to maximize the creditors' recovery, which is a legitimate objective of the CCAA. Thus, such powers were not unconstitutional, even if the Retailers were not insolvent.

Contestation of the Plan

The CCAA judge held that the contestation of the Plan was in fact a collateral attack of the November 2016 Order by the Retailers. In light of its conclusion on the first question, the QCA was not required to address this ground of appeal. The QCA did, however, note in *obiter* that notwithstanding the Plan, the November 2016 Order and the powers granted therein to the Monitor would survive, indicating its agreement with the conclusion of the CCAA judge.

Conclusion

The recognition by the QCA that a monitor may exercise the rights of creditors with a view to maximizing the CCAA estate is likely to be of significant importance in insolvency practice. Initiation of legal proceedings by the monitor on behalf of creditors will become another tool in the asset maximization toolbox, especially in light of the approval by the Supreme Court of Canada of litigation financing in an insolvency context in Bluberj.^[12]

[1] *Arrangement relatif à 9323-7055 Québec inc. (Aquadis International Inc.)*, 2020 QCCA 659. [Aquadis]

[2] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

[3] *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

[4] *Aquadis, supra*, note 1, at para. 21.

[5] The Retailers also argued that the proceedings against them were a misuse of resources of the Commercial Division of the Superior Court. This argument was dismissed by the QCA and is omitted for the purposes of brevity.

[6] As an example, please see *Muscletech Research and Development Inc. (Re)*, 2007 CanLII 5146 (Ont. Sup. Ct.).

[7] *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379, at para. 59.

[8] *Ernst & Young Inc. v. Essar Global Fund Limited*, 2017 ONCA 1014.

[9] *Aquadis, supra*, note 1, at para. 67.

[10] *9354-9186 Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10.

[11] Because the Retailers chose not to file a proof of claim.

[12] *9354-9186 Québec Inc. v. Callidus Capital Corp.*, 2020 SCC 10.